

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 MARC SPITZER, Chairman
4 JIM IRVIN
5 WILLIAM A. MUNDELL
6 JEFF HATCH-MILLER
7 MIKE GLEASON

8 In the matter of)

9 ***BEAR, STEARNS & CO. INC.,***)
10 ***383 Madison Avenue***)
11 ***New York, New York 10179***)
12 ***CRD# 79***)

DOCKET NO. S-03531A-03-0000

DECISION NO. 66298

Respondents.)

**ORDER TO CEASE AND DESIST, ORDER
FOR ADMINISTRATIVE PENALTIES AND
CONSENT TO SAME
BY: BEAR STEARNS & CO. INC.**

13
14 WHEREAS, Bear, Stearns & Co. Inc. ("Bear Stearns" or the "Firm") is a broker-dealer
15 registered in Arizona; and

16 WHEREAS, coordinated investigations into Bear Stearns' activities in connection with
17 certain conflicts of interest that research analysts were subject to during the period of July 1, 1999
18 through June 30, 2001 have been conducted by a multi-state task force and a joint task force of the
19 U.S. Securities and Exchange Commission, the New York Stock Exchange, and the National
20 Association of Securities Dealers (collectively, the "regulators"); and

21 WHEREAS, Bear Stearns has cooperated with regulators conducting the investigations by
22 responding to inquiries, providing documentary evidence and other materials, and providing
23 regulators with access to facts relating to the investigations; and

24 WHEREAS, Bear Stearns has advised regulators of its agreement to resolve the
25 investigations relating to its research practices; and
26

1 WHEREAS, Bear Stearns agrees to implement certain changes with respect to its research
2 and banking practices, and to make certain payments; and

3 NOW, THEREFORE, the Arizona Corporation Commission ("Commission") hereby enters
4 this Order:

5 I. JURISDICTION/CONSENT

6 Bear Stearns elects to permanently waive any right to a hearing and appeal under Articles
7 11 and 12 of the Securities Act of Arizona, A.R.S. §44-1801 *et seq.* ("Securities Act") and Title 14
8 of the Arizona Administrative Code with respect to this Order To Cease and Desist and Order for
9 Administrative Penalties ("Order"); neither admits nor denies the Findings of Fact and Conclusions
10 of Law contained in this Order, and consents to the entry of this Order by the Commission.

11 II. FINDINGS OF FACT

12 A. Background and Jurisdiction

13 1. Bear Stearns, a Delaware corporation with its principal place of business in New York,
14 New York, is a subsidiary of The Bear Stearns Companies, Inc. Bear Stearns provides equity
15 research, sales, and trading services; merger and acquisition advisory services; venture capital
16 services; and underwriting services on a global basis.

17 2. Bear Stearns is registered with the Securities and Exchange Commission
18 ("Commission"), is a member of the New York Stock Exchange, Inc. ("Exchange") and the NASD
19 Inc. ("NASD") and is licensed to conduct securities business on a nationwide basis.

20 3. Bear Stearns is currently registered in Arizona as a broker-dealer, and has been so
21 registered since March 1970.

22 4. This action concerns the time period of July 1, 1999 to June 30, 2001 (the "relevant
23 period"). During that time, Bear Stearns engaged in both research and investment banking ("IB")
24 activities.

B. Overview

1. During the relevant period, the Firm sought and did IB business with many companies covered by its research. Research analysts were encouraged to participate in IB activities, and that was a factor considered in the analysts' compensation system. In addition, the decision to initiate and maintain research coverage of certain companies was in some cases coordinated with the IB Department and influenced by IB interests.

2. As a result of the foregoing, certain research analysts at the Firm were subjected to IB influences and conflicts of interest between supporting the IB business at the Firm and publishing objective research.

3. The Firm had knowledge of these IB influences and conflicts of interest yet failed to establish and maintain adequate policies, systems and procedures that were reasonably designed to detect and prevent the influences and manage the conflicts.

C. Research Analyst Participation in Investment Banking Activities

1. Research analysts were responsible for providing analyses of the financial outlook of particular companies in the context of the business sectors in which those companies operated and the securities market as a whole.

2. Research analysts evaluated companies by, among other things, examining financial information contained in public filings, questioning company management, investigating customer and supplier relationships, evaluating companies' business plans and the products or services offered, building financial models and analyzing competitive trends.

3. After synthesizing and analyzing this information, analysts produced research in the form of full reports and more abbreviated formats that typically contained a recommendation, a price target, and a summary and analysis of the factors relied upon by the analyst.

4. The Firm distributed its analysts' research internally to various departments at the Firm and externally to the Firm's retail and institutional investing clients. In addition, the Firm sold some of its research directly to non-clients, disseminated it through distribution agreements with

1 other broker dealers, made it available to third party subscription services such as First Call, and
2 offered it for sale via market websites such as MultexInvestor.

3 5. In addition to performing research functions, certain research analysts participated or
4 assisted in IB activities. These IB activities included identifying companies as prospects for IB
5 services, participating in "pitches"¹ of IB services to companies, attending "road shows"²
6 associated with underwriting transactions, and speaking to investors to generate interest in
7 underwriting transactions.

8 6. In preparation for each "pitch" the bankers, with the analyst's input, prepared a "pitch
9 book" which was distributed at the meeting and contained a summary of the Firm's presentation.

10 7. The pitch books, in some instances, identified the covering analyst by name, provided
11 information about that analyst's background and reputation, sometimes characterizing the analyst
12 as the "ax" in his or her coverage sector, and highlighted the success of Bear Stearns' underwritten
13 IPOs covered by the analyst. The pitch books also highlighted such factors as the number of lead
14 and co-managed IPOs that the Firm currently had under research coverage. This information was
15 intended to convey to the issuer that such treatment would be accorded to it if Bear Stearns
16 received the mandate for the IB transaction.

17 8. The analyst's reputation played a role in pitching the Firm's IB services to potential
18 clients. Issuers often chose an investment bank because of the reputation of the analyst that would
19 cover the company's stock.

20 9. The pitch to an issuer by the research analyst contributed to Bear Stearns' ability to win
21

22 ¹ A "pitch" is a presentation made by bankers and research analysts to a potential IB client in order to obtain the
23 mandate for an upcoming IB transaction. In competing for an IB mandate, the Firm typically sent bankers and the
24 analyst to meet with company management to persuade the company to select the Firm as one of the investment
25 bankers in a contemplated transaction. At these "pitch" meetings Firm bankers would present their level of
26 expertise in the company's sector and discuss their previous experience with other such companies, as well as their
view of the company's merits and likelihood of success.

² A "road show" is a series of presentations made to potential investors in conjunction with the marketing of an
upcoming underwriting.

1 investment banking deals and receive investment banking fees from that and subsequent
2 investment banking relationships.

3 10. The investment banking division at Bear Stearns advised corporate clients and helped
4 them execute various financial transactions, including the issuance of stock and other securities.
5 Bear Stearns frequently served as the lead or as a co-lead underwriter in initial public offerings
6 ("IPOs") -- the first public issuance of stock of a company that has not previously been publicly
7 traded -- and follow-on offering of securities.

8 11. During the relevant period, investment banking was an important source of revenues
9 and profits for Bear Stearns. In 2000, investment banking generated more than \$965 million in net
10 revenues, or approximately eighteen percent of Bear Stearns' total net revenues.

11 12. The IB activities in which analysts participated also included participating in
12 commitment committee³ and due diligence activities in connection with underwriting transactions
13 and from time to time assisting the IB Department in providing merger and acquisition ("M&A")
14 and other advisory services to companies.

15 13. The Firm encouraged research analysts to support the IB and other businesses of the
16 Firm. With regard to IB, research analysts were encouraged to work in partnership with the IB
17 Department by participating in the foregoing IB activities, and the level of certain research
18 analysts' participation in these IB activities was sometimes significant.

- 19 a. On September 23, 1999, the Head of Research provided research analysts with
20 guidelines to follow in drafting their business plans. The guidelines stated they
21 were "designed to help [the research analysts] focus on executing and delivering
22 [their] goals, improving [their] overall contribution to the firm and enhancing [their]
23 relationships with [their] partners throughout the firm." These guidelines requested
24 the research analysts to describe their contributions to nine separate areas of the

25 ³ The "commitment committee" was responsible for, among other things, evaluating and determining the Firm's
26 participation in IPOs and other IB transactions.

1 Firm's business. With respect to the area identified as "Banking," the guidelines
2 stated: "After your business plan meeting with your bankers please discuss any
3 ideas you have generated for deal origination and timing of coverage for existing or
4 proposed corporate relationships. Include or attach to your business plan a list of
5 stocks you and your corporate finance team have agreed upon as priorities. Include
6 plans to help market transactions or to introduce M&A activity. Discuss any plans
7 to drop coverage where there is no longer a strategic fit."

- 8 b. In her 1997/1998 business plan, an analyst stated, "If I were any more aggressive in
9 the banking area, my office would be on the third floor [location of IB offices of the
10 Firm]."

11 14. In connection with their participation in IB activities, certain research analysts and
12 investment bankers ("bankers") communicated, in various frequency and extent, through meetings
13 and via telephone and electronic mail ("e-mail").

14 15. The IB department at the Firm was organized into industry groups that corresponded to
15 certain research sectors. Research analysts were aware that, in certain circumstances, their
16 positive and continued coverage of particular companies was an important factor for the generation
17 of investment banking business. Thus, some research analysts and bankers coordinated the
18 initiation and maintenance of research coverage, based upon, among other things, investment
19 banking considerations.

- 20 a. On February 9, 2000, two bankers and an analyst submitted a joint business plan to the
21 co-heads of the IB technology group. The stated purpose of the memorandum was to
22 "describe a strategy for investment banking and research coverage and coordination of
23 companies which provide Internet enabling technologies. The near-term goal is to
24 establish an organized and prioritized calling effort with an emphasis on cultivating
25 fewer and deeper, lead managed relationships." [Emphasis in original.]

26 **D. Participation in Investment Banking Activities was a Factor in Evaluating and**

Compensating Research Analysts

1
2 1. The compensation system at the Firm provided an incentive for research analysts to
3 contribute to all areas of the Firm's business, including participating in IB activities and assisting in
4 generating IB business for the Firm. Research analysts' participation in IB activities was one of
5 several factors considered in determining their compensation. Notes of staff meetings reflect the
6 following statements by the Head of Research to analysts:

7 a. "I'd like to remind everyone how you get paid at Bear Stearns. It is based on your
8 contribution to your team and your contribution to the firm . . . Notice that being a
9 partner with banking is part of the analyst job description. You are not compared or
10 matrixed or in any way paid on a formula. Working on transactions is not
11 incremental to your compensation, it is an expected part of it."

12 b. "I need to remind you that investment banking revenues are not incremental to your
13 bonus. Being a partner to banking is part of your job. You are paid on performance
14 and based on your contribution to the firm."

15 2. The performance of research analysts was evaluated through an annual review process.
16 Where not set by contract, the research analyst's salary and annual bonus were also determined
17 through this process.

18 3. Information on the analyst's job performance was gathered through annual self-
19 evaluations, analyst's business plans, surveys of management, and trading and institutional sales
20 department personnel, e-mail and oral feedback from employees in the IB and other departments at
21 the Firm, and the Firm's institutional clients.

22 4. The research analysts' annual business plans contained, among other things, their
23 contributions to various areas of the Firm, including IB, for the past year, and their plans for
24 improving their contribution to these areas of the Firm, including IB, in the coming year.

25 5. In their self-evaluations, which were used to communicate their accomplishments to and
26 petition management for increased compensation analysts discussed such areas as their rankings in

1 independent research polls, the scope of their research coverage, their participation in industry
2 conferences, and the Firm's Autex rankings in stocks they covered. Certain research analysts
3 provided extensive information regarding their assistance to IB, including accomplishments, goals,
4 and participation in lead- and co-managed underwritings, and sometimes also including the
5 revenues to the Firm associated with the IB transactions on which the analyst worked. In addition,
6 analysts were occasionally requested to inform research management of fees generated by the IB
7 transactions on which they worked.

8 a. In an October 24, 2000 e-mail to the Head of Research, a senior analyst summarized his
9 9 key accomplishments during fiscal year 2000. The first and largest point, which dealt
10 with his contributions to IB, stated as follows: "*Corporate finance: generated over \$23
11 million in fees to the firm in nine separate transactions: *Storage networking: identified
12 a new financial opportunity for the firm, which resulted in six transactions... I should be
13 designated as a finder for Ancor [Ancor Communications], JNI [JNI Corp.] and Vixel
14 [Vixel Corp.]. *iAppliances: identified a new industry category ...which was a source of
15 two IPOs... *Agilent [Agilent Technologies]: I should be designated as a finder -- or at
16 least a save for Agilent. BS pitched the business and lost. I went in and re-won the
17 business, generated fees of around \$2.5 million to the firm." The e-mail to the Head of
18 Research included a spreadsheet listing the IB transactions on which he had worked and
19 the associated revenues to the Firm. The Head of Research praised the format of the
20 summary and suggested she might have all research analysts submit theirs in the same
21 form.

22 b. In a June 21, 2001 e-mail from a member of the research management staff, the
23 research analysts were requested to submit information regarding all banking
24 transactions that had closed or that were pending in their sectors during the prior 6
25 month period.

1 6. Certain research analysts perceived that the amount of their bonus would be influenced
2 by their contribution to and impact on the firm's IB business, and the fees generated by IB
3 transactions on which they worked.

4 7. Research analysts were encouraged to support and assist all areas of the Firm and to
5 participate in IB activities and activities that enhanced the reputation of the Firm's IB business.
6 Based upon statements by research management indicating that partnership with banking was part
7 of their job as research analysts, the inclusion of a "Banking" section in their annual business plans,
8 information regarding IB transactions in their self-evaluations, and requests from research
9 management for specific information regarding IB transactions in their coverage sectors, certain
10 research analysts believed that the revenues generated by their participation in IB activities was an
11 important factor in their evaluations and compensation. Accordingly, some research analysts were
12 encouraged to participate in IB activities, increase IB revenues, and enhance the reputation of the
13 Firm, including its IB business.

14 8. Research Analysts' salaries and bonuses were determined by a multiple factor-based
15 approach. Among other things, analysts were judged for compensation purposes based on the
16 performance of their stock picks, their impact on the buy-side accounts as measured by votes, the
17 Firm's market share in trading volume in the stocks they covered, their participation in IB
18 activities, and the fees and secondary trading commissions generated from those activities were
19 considered.

20 **E. Investment Banking Interests Influenced the Firm's Decisions to Initiate and Maintain**
21 **Research Coverage**

22 1. In general, the Firm determined whether to initiate and maintain research coverage
23 based upon institutional investors' interest in the company, and the company's importance to the
24 sector or IB considerations, such as attracting companies to the Firm to generate IB business or
25 maintaining a positive relationship with existing IB clients.
26

1 2. The nature and duration of research coverage were important criteria for a company's
2 choice of a broker dealer for IB services. The pitch books typically contained information stating,
3 among other things, that: "an important element to successfully executing an IPO is having an
4 assurance that the Firm will provide research coverage to the IPO candidate in the offering and in
5 the aftermarket."

6 3. The Firm generally initiated coverage on companies that engaged the Firm in an IB
7 transaction. In pitching for IB business, the Firm sometimes represented to the company the
8 frequency with which reports would be issued.

9 4. The Firm's ratings system, which was intended to reflect the long-term prospects of a
10 rated stock, allowed research analysts to assign one of five ratings to a stock: (1) "Buy" - Expected
11 to outperform the local market by 20% in the next 12 months. Strong conviction and typically
12 accompanied by an identifiable catalyst; (2) "Attractive" - Expected to outperform the local market
13 by 10% or more, it is usually more difficult to identify the catalyst; (3) "Neutral" - Expected to
14 perform in line with the local market; (4) "Unattractive" - Expected to underperform the local
15 market; and (5) "Sell" - Avoid the stock.

16 5. During the relevant period, there was a sharp downturn in the stock market and stocks
17 in certain sectors performed poorly. During this period, the Firm did not issue ratings of
18 "Unattractive" or "Sell" in connection with any covered companies in these sectors.

19 6. Research management communicated with IB management to ensure that research
20 opportunities were appropriately aligned with identified IB opportunities.

21 7. The Stock Selection Committee was ultimately responsible for making the
22 determination to initiate coverage of a given company. The Head of Research was ultimately
23 responsible for making the determination to maintain research coverage. Nonetheless, IB
24 considerations sometimes influenced the decision to initiate and maintain coverage.

1 8. Some research analysts and bankers actively coordinated the initiation and maintenance
2 of research coverage based upon, among other things, IB considerations. This coordination
3 consisted of meetings and communications by telephone and e-mail.

4 9. In some circumstances, research coverage was initiated based on IB considerations.

5 a. In an April 19, 2000 e-mail from a member of his staff, the head of the IB Technology
6 Group communicated the following to the Heads of Research and IB as well as
7 numerous analysts and bankers: "[Analyst A] and [Analyst B] agree that [Analyst B]
8 will be the analyst covering CacheFlo [Cacheflow]. [Banker] and [Analyst B] will
9 discuss with CacheFlo what the planned timing of their offering will be so as to insure
10 that if we initiate coverage in advance of the transaction we will not be prohibited from
11 being an underwriter. [Analyst B] and [Banker] will also stress to the company that if
12 we initiate coverage we expect our position in the company's future financing and
13 strategy actions to be materially improved."

14 10. Given that research analysts participated in determining in which IB transactions in
15 their sectors the Firm would participate, if the Firm determined to participate in an equity offering
16 for a company, it was expected the company would qualify for an initial "Buy" rating.

17 11. An analyst who anticipated initiating coverage of such a company with less than a
18 "Buy" rating informed IB in advance as follows.

19 a. In a February 8, 2000 e-mail to bankers and the Head of Research, this analyst stated:
20 "Just wanted to be sure that everyone knows that we will be using an Attractive rating
21 on go.com. If anyone has any comments or issues, please let me know."

22 b. In a March 17, 2000 e-mail to research analysts, an associate analyst stated: "I talked to
23 [the liaison between research and IB] and we have the go ahead to initiate on IPET
24 [Pets.com] with an Attractive rating. According to [the liaison] we should explain
25
26

1 somewhere in the text, why our opinion about the company's prospects have changed
2 from the time we initiated coverage."⁴

- 3 c. In his annual evaluation, this analyst was criticized as follows: "Has been working
4 poorly w/bankers - in changing opinions after the firm has committed to co. mgmts".
5 The analyst testified that he believed the statement related to his communicating his
6 opinions regarding companies to bankers in a timely manner, and that if his opinion
7 regarding a company changed from a more positive opinion to a more negative opinion
8 about a company after a banker had already made some sort of commitment to a
9 company, it made life difficult for the banker and was not ideal from his standpoint. He
10 went on to testify that, particularly in his highly volatile sector, companies often
11 changed a lot between the time of the first organizational meeting and the date of the
12 IPO.

13 12. In some circumstances, the determination to maintain research was influenced by IB
14 considerations.

- 15 a. Due to IB influences a supervisory analyst perceived and communicated to others that
16 IB approval was required before coverage could be dropped. In response to an inquiry
17 by an associate analyst regarding dropping coverage of 2 companies, a supervisory
18 analyst stated in an April 19, 2002 e-mail: "[The Head of Research] says before
19 dropping coverage, you need to get permission from both: 1. the market makers on the
20 trading desk, 2. the bankers."
- 21 b. In an April 3, 2000 e-mail to the Heads of Research and IB as well as numerous
22 members of both departments, a banker discussed a company's decision to exclude the
23 Firm from a follow-on offering. He stated: "I expressed significant disappointment with
24 the fact that they neglected to discuss this issue with us prior to this time and that they
25 left us no choice but to drop research coverage and trading, since they obviously did not

26 ⁴ In fact, Bear Stearns had not yet initiated coverage on IPET at the time this e-mail was sent.

1 value our support to date. [Analyst] - As we discussed, feel free to drop at any time. I
2 told the CFO that you would likely put out a note, but did not know when." In a follow-
3 up e-mail the Head of Research stated that she agreed with the decision to drop
4 coverage. The analyst ultimately determined not to drop coverage.

5 **F. Research Analysts Were Visible on Stocks to Generate Investment Banking Business**

6 1. Issuers also considered investment banks' aftermarket trading support as a factor in
7 selecting an investment bank. The Firm's trading volume and trading rank were factors it promoted
8 to IB clients in pitch presentations.

9 2. The Firm distributed to sales and trading personnel and research analysts the "Trading
10 Focus List," which contained stocks of companies from which the Firm was seeking or with which
11 the Firm had IB business.

12 3. A research analyst actively marketed companies on the Trading Focus List in order to
13 obtain IB business.

14 a. In a December 10, 1999 e-mail, an analyst wrote the following to Equity Trading copied
15 to the Heads of Research and IB: "Subject: Pls make the trading of Packeteer a top
16 priority. I spent two days with Packeteer ('PKTR') management this week visiting
17 investors. Management are extremely happy with our research coverage and banking
18 services. But they have repeatedly indicated to me that our trading stat. is not
19 satisfactory...CEO hinted to me many times that we have a chance for the books for the
20 secondary if we improve the trading...They are likely to do a secondary in Q1 - mostly
21 likely late January/early February; could be as much as \$200 MM deal. Please help us
22 in improving our trading immediately. We will do whatever it takes from the research
23 side."

24 b. In a September 14, 2000 e-mail to Equity Trading the same analyst wrote the following
25 regarding banking client SonicWall ("SNWL"): "We need help in boosting our trading
26 stat for SNWL. Both management and their VC called me yesterday complaining about

1 our trading - #2 in August and #3 so far in September. More importantly, they argued
2 that we are not supporting the stock when it is weak...I made a positive call on Monday
3 but am not getting much support. Pls help us here since this important technology client
4 indicated to me that if we do not improve, it will hurt our banking relationship with the
5 company."

6 c. In a March 8, 2001 e-mail the same analyst again wrote to Equity Trading regarding
7 two IB clients he covered: "Subject: MUSE [Micromuse] and ISSX [Internet Security
8 Systems] autex - both on focus list. On MUSE - we dropped from #3 or 4 in 2000 to
9 #10 in Feb and March to date. I just called the trader to see what we can do. I have been
10 extremely active on the name- took management to Boston, Denver, Minneapolis and
11 KC in February alone. Do not quite understand. Pls follow up. ISSX - we dropped from
12 #2 or #3...to #11 in March. I am very active on ISSX also. Thanks for your help on
13 this." Equity Trading responded: "What do you want me to do? Get some orders on the
14 stock yourself. Generate some order flow!!" The analyst replied: "I am trying...but are
15 the traders on these two stocks good?"

16 4. In order to raise or maintain the Firm's visibility on stocks with which the Firm wanted
17 to do IB business, certain research analysts nominated companies to participate at Firm sponsored
18 conferences, took company managements on non-deal road shows, hosted field trips for
19 institutional investors to companies' headquarters and arranged other meetings between
20 institutional investor clients and companies.

21 5. Research analysts were visible on stocks of companies with which the Firm wanted to
22 do IB business in order to generate IB business.

23 **G. Research Analysts Were Subject to Pressure by Covered Companies**

24 1. Certain research analysts communicated regularly with employees of the companies that
25 they covered, including executive and senior management of those companies. These
26

1 communications occurred through telephone and e-mail exchanges, company-sponsored events,
2 and analyst calls.

3 2. Research analysts were sometimes subject to pressure from companies they covered to
4 issue better ratings and recommendations. Research analysts understood that negative ratings and
5 recommendations could adversely affect the Firm's ability to attract and retain IB business from
6 those companies.

7 a. On November 2, 2000, in his 2000 self-evaluation an analyst wrote in a section entitled
8 "Areas to Improve: We want our banking clients to know that our research is objective
9 and independent but always sensitive to their best interests. There have been instances
10 in my career where certain banking clients felt that our research and public comments
11 weren't sensitive to their interests. This is a very important issue for us and we take it
12 most seriously. We will continue to make every effort to be sensitive to our clients and
13 our banking partners."

14 3. When research analysts downgraded or issued a negative comment on a banking client,
15 they sometimes received direct feedback from high-ranking company officials.

16 a. In an August 24, 2000 e-mail, a banking client responding to a downgrade of his
17 company wrote: "Your earnings estimates are on track, however, given the downgrade,
18 I sure would have liked to see you give us a lower bar on revenue...[W]hile we affirmed
19 the revenue estimate, they were definitely a stretch. Seems a shame to waste a
20 downgrade by not buying the opportunity for us both to over-perform going forward..."

21 **H. In Certain Instances, the Firm Published Exaggerated or Unwarranted Research**

22 1. On several occasions, the conflicts of interest discussed above resulted in analysts
23 publishing recommendations and/or ratings that were exaggerated or unwarranted, and/or
24 contained opinions for which there was no reasonable basis. The following are examples of how
25 these conflicts affected the research.

- 1 a. Bear Stearns lead managed the IPO and secondary offerings for SonicWall in
2 November 1999 and March 2000 respectively. An analyst rated the stock a "Buy" from
3 the IPO until April 2002. In January 25, 2001 while they were participating in a
4 SonicWall conference call the analyst stated to his associate: "I am trying to make them
5 look good...on the dso and the growth etc." A few minutes later he added: "we got paid
6 for this...and I am going to Cancun tomorrow b/c of them!"
- 7 b. Bear Stearns initiated coverage of MUSE with an "Attractive" rating in September
8 1999, raised the rating to a "Buy" in January 2000 and maintained a "Buy" rating on the
9 stock until July 2002. While listening to a MUSE analyst call on July 18, 2001, an
10 analyst suggested to his associate that he was going to downgrade his rating on the
11 stock to "Attractive". The associate disagreed with the suggestion and the analyst
12 responded that the stock was "dead money!" However, the analyst did not downgrade
13 his rating on the stock, instead issuing research the same day maintaining his "Buy"
14 rating.
- 15 c. Bear Stearns lead managed the IPO for CAIS Internet, Inc. in May 1999. The analyst
16 rated the stock a "Buy" from the IPO through his last report on the company in
17 November 2000. On January 24, 2001, in response to an e-mail reporting extensive
18 service failures at CAIS the analyst stated: "Any other scoop on this piece of shit?" A
19 few days later, in response to an institutional client's request for his thoughts on CAIS'
20 4th quarter, the analyst stated: "It's up a lot year to date...don't overstay your welcome
21 on this one."
- 22 d. Bear Stearns co-managed the IPO and secondary offerings for Digital River in August
23 and December 1998 respectively. The Firm, via three successive analysts, rated the
24 stock a "Buy" from the IPO until April 2002. In an April 1, 2002 e-mail to his IB
25 counterpart an analyst stated: "I have to tell you, I feel a bit compromised today. I have
26 told every client on the phone that they should avoid or short the stock over the last few

1 months. I have been fairly hands-off on DRIV [Digital River, a stock under his
2 coverage], primarily because of the banking prospect that you and [Another Banker]
3 have noted. Today, clearly the stock is down a lot. The artificial Buy rating on the
4 stock, while artificial, still makes me look bad. In the future, I'd like to have more
5 leeway with the ratings, even for companies like Digital River, where we have a
6 relationship on the banking side. I trust it would benefit all of us."

7 **I. The Firm Made A Payment for Research**

8 1. In August 2000, as part of an offering that took place in May 2000, the Firm made a
9 payment of \$102,750 to another broker-dealer in connection with research coverage it provided for
10 Andrx Corp. ("ADRX"), a Bear Stearns' investment banking client in connection with an
11 underwriting transaction for which Bear Stearns was a lead manager.

12 2. Bear Stearns did not take steps to ensure that this broker-dealer disclosed in its research
13 that it had been paid to issue research on ADRX. Further Bear Stearns did not disclose or cause to
14 be disclosed the details of this payment.

15 **J. Bear Stearns Failed to Adequately Supervise Its Research and Investment Banking**
16 **Departments**

17 1. While the role of the research analysts was to produce objective research, the Firm also
18 encouraged them to participate in IB activities. As a result of the foregoing, research analysts were
19 subject to IB influences and conflicts of interest between supporting the IB business at the Firm
20 and publishing objective research.

21 2. The Firm had knowledge of these IB influences and conflicts of interest yet failed to
22 manage them adequately to protect the objectivity of its published research.

23 3. Bear Stearns failed to establish and maintain adequate policies, systems and procedures
24 reasonably designed to ensure the objectivity of its published research. Although Bear Stearns had
25 some policies governing research analyst activities during the relevant period, these policies were
26 inadequate and did not address the conflicts of interest that existed.

III.**CONCLUSIONS OF LAW**

1. The Commission has jurisdiction over this matter pursuant to Article XV of the Arizona Constitution and the Securities Act.

2. The Firm violated A.R.S. §44-1961(A)(13) by:

- i. failing to ensure that analysts who issued research were adequately insulated from pressures and influences from covered companies and investment banking; and
- ii. failing to reasonably supervise its employees to ensure that its analysts who issued research were adequately insulated from pressures and influences from covered companies and investment banking.

3. The Firm's conduct is grounds for administrative penalties under A.R.S. § 44-1961(B)(1).

4. The Firm's conduct is grounds for a cease and desist order pursuant to A.R.S. § 44-1961(B)(2).

5. The Firm's conduct is grounds for an order requiring the Firm to take affirmative action to correct the conditions and practices giving rise to this action pursuant to A.R.S. § 44-1961(B)(3).

IV.**ORDER**

On the basis of the Findings of Fact, Conclusions of Law, and Bear Stearns' consent to the entry of this Order, for the sole purpose of settling this matter, prior to a hearing and without admitting or denying any of the Findings of Fact or Conclusions of Law, the Commission finds that the following relief is appropriate, in the public interest, and necessary for the protection of investors.

THEREFORE, IT IS HEREBY ORDERED:

1. This Order concludes the investigation by the Commission and any other action that the Commission could commence under applicable Arizona law on behalf of Arizona as it relates to Bear Stearns, relating to certain research practices at Bear Stearns described herein.

2. Pursuant to A.R.S. § 44-1961(B)(2) and (3), Bear Stearns will CEASE AND DESIST from

1 violating A.R.S. §44-1961(A)(13) in connection with the research practices referenced in this Order
2 and will comply with the undertakings of Addendum A, incorporated herein by reference.

3 3. Pursuant to A.R.S. § 44-1961(B)(1), Bear Stearns shall pay an administrative penalty in the
4 amount of \$395,321.00.

5 4. If payment is not made by Bear Stearns or if Bear Stearns defaults in any of its obligations
6 set forth in this Order, the Commission may vacate this Order, at its sole discretion, upon 10 days
7 notice to Bear Stearns and without opportunity for administrative hearing.

8 5. Bear Stearns agrees that it shall not seek or accept, directly or indirectly, reimbursement or
9 indemnification, including but not limited to payment made pursuant to any insurance policy, with
10 regard to all penalty amounts that Bear Stearns shall pay pursuant to this Order or section II of the
11 SEC Final Judgment, regardless of whether such penalty amounts or any part thereof are added to
12 the Distribution Fund Account referred to in the SEC Final Judgment or otherwise used for the
13 benefit of investors. Bear Stearns further agrees that it shall not claim, assert, or apply for a tax
14 deduction or tax credit with regard to any state, federal or local tax for any penalty amounts that
15 Bear Stearns shall pay pursuant to this Order or section II of the SEC Final Judgment, regardless of
16 whether such penalty amounts or any part thereof are added to the Distribution Fund Account
17 referred to in the SEC Final Judgment or otherwise used for the benefit of investors. Bear Stearns
18 understands and acknowledges that these provisions are not intended to imply that the Commission
19 would agree that any other amounts Bear Stearns shall pay pursuant to the SEC Final Judgment
20 may be reimbursed or indemnified (whether pursuant to an insurance policy or otherwise) under
21 applicable law or may be the basis for any tax deduction or tax credit with regard to any state,
22 federal or local tax.

23 6. This Order is not intended by the Commission to subject any Covered Person to any
24 disqualifications under the laws of any state, the District of Columbia or Puerto Rico (collectively,
25 "State"), including, without limitation, any disqualifications from relying upon the State
26 registration exemptions or State safe harbor provisions. "Covered Person" means Bear Stearns, or

1 any of its officers, directors, affiliates, current or former employees, or other persons that would
2 otherwise be disqualified as a result of the Orders (as defined below).

3 7. The SEC Final Judgment, the NYSE Stipulation and Consent, the NASD Letter of
4 Acceptance, Waiver and Consent, this Order and the order of any other State in related proceedings
5 against Bear Stearns (collectively, the “Orders”) shall not disqualify any Covered Person from any
6 business that they otherwise are qualified, licensed or permitted to perform under the applicable
7 law of Arizona and any disqualifications from relying upon this state’s registration exemptions or
8 safe harbor provisions that arise from the Orders are hereby waived.

9 8. The Orders shall not disqualify any Covered Person from any business that they otherwise
10 are qualified, licensed or permitted to perform under applicable state law.

11 9. For any person or entity not a party to this Order, this Order does not limit or create any
12 private rights or remedies against Bear Stearns including, without limitation, the use of any e-mails or
13 other documents of Bear Stearns or of others regarding research practices, or limit or create liability of
14 Bear Stearns, or limit or create defenses of Bear Stearns to any claims.

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10. Nothing herein shall preclude Arizona, its departments, agencies, boards, commissions, authorities, political subdivisions and corporations, other than the Commission and only to the extent set forth in paragraph 1 above, (collectively, "State Entities") and the officers, agents or employees of State Entities from asserting any claims, causes of action, or applications for compensatory, nominal and/or punitive damages, administrative, civil, criminal, or injunctive relief against Bear Stearns in connection with certain research practices at Bear Stearns.

IT IS FURTHER ORDERED that this Order shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

/s/ Marc Spitzer

CHAIRMAN

William A. Mundell

COMMISSIONER

Jeffrey Hatch-Miller

COMMISSIONER

Lowell Gleason

COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 24th day of September, 2003.

/s/ Brian C. McNeil

BRIAN C. McNEIL

Executive Secretary

Jim Irvin

DISSENT

DISSENT

This document is available in alternative formats by contacting Yvonne McFarlin, Executive Assistant to the Executive Secretary, voice phone number 602-542-3931, E-mail ymcfarlin@cc.state.az.us.

(PAH)

CONSENT TO ENTRY OF ADMINISTRATIVE ORDER
BY BEAR STEARNS

BEAR STEARNS hereby acknowledges that it has been served with a copy of this Administrative Order, has read the foregoing Order, is aware of its right to a hearing and appeal in this matter, and has waived the same.

BEAR STEARNS admits the jurisdiction of the Commission, neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order; and consents to entry of this Order by the Commission as settlement of the issues contained in this Order.

BEAR STEARNS states that no promise of any kind or nature whatsoever was made to it to induce it to enter into this Order and that it has entered into this Order voluntarily.

Mark E. Lehman represents that he/she is General Counsel of BEAR STEARNS and that, as such, has been authorized by BEAR STEARNS to enter into this Order for and on behalf of BEAR STEARNS.

Dated this 21st day of August 2003.

BEAR STEARNS & CO. INC.

BEAR STEARNS & CO. INC.

By: _____

By: /s/ Mark E. Lehman

Title: Senior Managing Director
and General Counsel

Title: _____

SUBSCRIBED AND SWORN TO before me this 21st day of August, 2003.

/s/ Patrick B. Maloney

Notary Public

My Commission expires:

6/15/07